

Submission to the Standing Senate Committee on Social Affairs, Science and Technology

Comments on Bill S-5

April 5th, 2017

About the NCACT

The National Coalition Against Contraband Tobacco (NCACT) is a Canadian advocacy group formed in 2008 with the participation of businesses, organizations and individuals concerned about the growing danger of contraband tobacco. The NCACT's eighteen members share the goals of working together to educate people and urge government to take quick action to stop this growing threat.

The NCACT works to raise awareness amongst all levels of government and the public about contraband tobacco, as well as to encourage meaningful action on this important problem. More information about the Coalition can be found on our website, www.stopcontrabandtobacco.ca.

The members of the NCACT are: Association des détaillants en alimentation du Québec (ADA), Association des marchands dépanneurs et épiciers du Québec (AMDEQ), Canadian Chamber of Commerce, Canadian Convenience Stores Association (CCSA), Canadian Manufacturers and Exporters, Canadian Taxpayers Federation, Canadian Tobacco Manufacturers Council, Conseil du patronat du Québec (CPQ), Customs and Immigration Union, Échec au crime Québec, Fédération des chambres de commerce du Québec (FCCQ), Frontier Duty Free Association (FDFA), National Capital Area Crimes Stoppers, National Convenience Stores Distributors Association (NACDA), Ontario Chamber of Commerce, Retail Council of Canada, Toronto Crime Stoppers and United Korean Commerce and Industry Association (UKCIA).

Contraband Tobacco in Canada

The National Coalition Against Contraband Tobacco's focus is reducing the incidence of illegal cigarettes in Canada. The continued high-rate of contraband tobacco in Canada funds organized crime and undermines the effectiveness of existing tobacco control measures. As such, our primary concern regards how S-5 will affect the incidence of illegal cigarettes in Canada. There is every reason to believe that the introduction of plain and standardized packaging will increase an already bustling illegal market.

Contraband tobacco is a major problem in Canada. About 1 in 3 cigarettes purchased in Ontario are illegal¹ and Quebec has identified a contraband incidence of about 15%². In fact, Ontario has the second worst contraband tobacco problem in the Americas, with volumes similar to in El Salvador.³ Police are seizing more and more illicit tobacco products heading into Atlantic Canada and the Prairies. Contraband tobacco is a boon for organized crime, with the Royal Canadian Mounted Police (RCMP) identifying

¹ See <http://stopcontrabandtobacco.ca/wp-content/uploads/2017/01/17-01-12-ILLICIT-MONITOR-ONTARIO-FOR-RELEASE.pdf>

² "The Quebec Economic Plan 2017", Appendix B.9

³ Project Frost, KPMG, May 27 2015.

about 175 criminal gangs involved in the trade; who use the proceeds to fund their other illegal activities, including guns, drugs and human smuggling.

A major source of contraband tobacco in Canada is illegal production. The RCMP have identified 50 illegal factories operating in Canada. In addition, there are more located in the United States in Indigenous communities that straddle the Canada-US border, such as those identified near Cornwall, Ontario.

These factories are not small operations. They use industrial cigarette manufacturing equipment that can produce millions of cigarettes annually- as many as 10,000 a minute. A sense of the scale of the operations is possible just from seized raw leaf tobacco alone. In the Cornwall area, the Cornwall Regional Task Force regularly reports seizing 1000 kg of tobacco or more. In late March, enough tobacco to make more than 1 million cigarettes was seized at a vacation property in the region⁴. A little more than a year ago, *Projet Mygale*, the largest contraband tobacco bust in history, disrupted a network that had smuggled more than 2 million kilograms of tobacco over the 20 months of the investigation. That’s enough tobacco to produce about 4 billion cigarettes with an estimated \$530 million in lost taxes.

Historically, contraband tobacco has been generally sold in resealable plastic bags. These “baggies” were sold inexpensively and smuggled widely. However, the market has increasingly become more sophisticated and has moved more towards illegal packs.

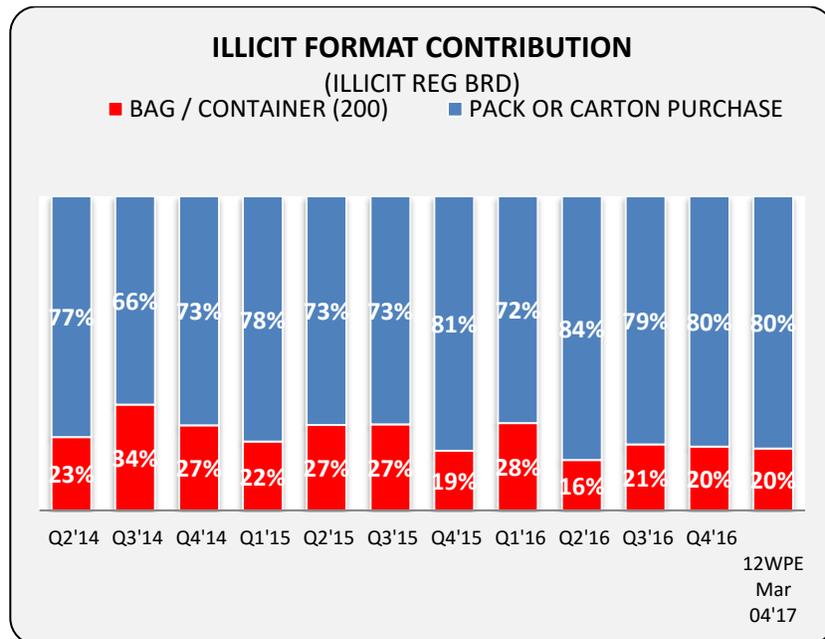


Figure 1: Format of Illegal Cigarettes in Ontario. Source: GFK, March 2017

⁴ RCMP News release: “Contraband Seizure at Hamilton Island Shoreline Property”, March 27, 2017 <http://www.rcmp-grc.gc.ca/en/news/2017/27/contraband-seizure-hamilton-island-shoreline-property>

Packs come from a variety of sources. They can come from tax exempt legal products that have been diverted from their intended purpose; as is the case with the allocation program. It can include tobacco products manufactured for sale directly to First Nations community members, where federal, but not provincial taxes are paid. They can also include cigarettes that follows no regulations and pay no tax, but is sold in a pack form.

There is no doubt that illegal cigarette manufacturers in Canada have advanced and elaborated upon existing production capacities.

Contraband tobacco has clear social harms over and above the general harms of tobacco. For example, it funds organized crime, with the RCMP having identified about 175 criminal gangs that use the sale of illegal cigarettes to fund other activities. It also represents lost revenue to the government, meaning taxpayers shoulder the burden of the social costs of contraband tobacco consumption directly.

Moreover, illegal cigarettes reduce the efficacy of tobacco control regulations, especially those designed to prevent young people from smoking. Identification requirements, advertising and display restrictions, and tobacco taxes are all designed to make it more difficult for young people to access cigarettes. Contraband's low cost and easy availability undercut these measures.

How does Plain Packaging Affect Contraband?

Barring real changes that address Canada's contraband tobacco market, the addition of plain packaging will increase the availability of the illegal product. Plain packaging will also create a clear opportunity for illegal manufacturers to move into direct counterfeiting of tobacco.

In jurisdictions that have adopted plain packaging requirements, like Australia, there has been an increase in contraband tobacco availability. Sinclair Davidson, an economics professor at Melbourne's RMIT University, has highlighted that contraband tobacco increased by 26% in Australia following the introduction of plain packaging⁵. Unlike Australia, Canada's has an elaborate domestic illegal cigarette production capacity that is relatively unique in the developed world, meaning that Canada's experience with contraband following the introduction of plain packaging will likely see a similar effect on contraband tobacco incidence.

As highlighted, the 50 illegal factories that the RCMP has identified in Canada are not small operations. They have industrial production capacity, with the ability to produce as many as 10,000 cigarettes a minute, and have access to modern industrial printers that can easily produce authentic-looking packaging.

Currently, legal tobacco products have complicated packaging to duplicate. The use of colours, embossing, and other advanced printing techniques requires specialized equipment and designs that are not easily acquired or duplicated. Plain packaging regulations however, will give the blueprint for replicating the packaging of legal product; including graphic warning labels, colours, fonts, and other necessary materials. Even if details are not outlined in regulations, the nature of simple, drab designs

⁵ See "The Australian Plain Packaging Experience" by Sinclair Davidson, Slide 19. <http://catallaxyfiles.com/files/2016/04/The-Australian-Plain-Packaging-Experience-1.pptx> (Accessed 2016-08-29). Contraband increased from 11.5% in 2012 to 14.5% in 2014 following plain packaging's introduction.

makes them easy to reverse engineer effectively in a short period of time. Similarly, illegal manufacturers would be able to use commercially available printing equipment to manufacture packaging.

Illegal manufacturers would have little difficulty creating authentic-looking counterfeits of legitimate product. The average consumer would have little ability to tell the difference between legitimate and illegitimate product. For no additional cost, illegal manufacturers could produce counterfeit cigarettes that they are able to sell at a premium over the traditional illegal product.

Additional restrictions on packaging will have no impact on the existing illegal market. Smokers that choose to purchase illegal tobacco will not be affected by additional restrictions on the illegal market designed to deter consumption. The illegal market already avoids current packaging requirements, such as size and type of health warning.

A visit to any of the more than 300 smoke shacks that operate in Canada will highlight this, with a plethora of brands and options on open display, a far cry from what is expected in the legal market. There's no reason to believe that this would change following the introduction of even more restrictive measures and, if anything, it would mean that illegal product would have even more opportunities to create the attractive packaging that the government is trying to cease.

The Federal Government should be concerned about what plain packaging regulations will do to expand the illegal market beyond the existing status quo. While counterfeit tobacco remains a relatively small part of the illegal market in much of the country, plain packaging will make it very easy for illegal manufacturers to expand counterfeit operations.

Illegal cigarette manufacturers will also experience similar benefits from proposals that would set new standards for the manufacture of actual cigarette sticks. Such proposals could include restrictions on size, shape of filter, and restrictions on labelling cigarettes. As with packs, these differences require manufacturing equipment that most illegal manufacturers do not have access to. A common approach would make it all but impossible for consumers or law enforcement to identify illegal product without close, careful inspection.

Plain packaging regulations would create a fertile market for the counterfeiting of Canadian brands and expand scope and profits for illegal manufacturers. Because counterfeit product will be virtually indistinguishable from legal product, there will be an incentive for organized crime groups to strong-arm legitimate retailers to move illegitimate product. Complex packages prevent against this.

There are very real reasons to believe that plain packaging regulations would create new opportunities for illegal manufacturers that would increase their profits and further confuse consumers. The continued size and scope of the illegal market would also undermine the efficacy of any new regulations, let alone existing ones, to curb tobacco consumption.

Solution: Licence non-tobacco manufacturing materials, particularly filters and filter components

There is no one silver bullet to eliminating contraband tobacco. Addressing the problem will require a mix of responses to reduce demand and supply. Focusing on supply offers the federal government an opportunity to have the greatest impact for its efforts in the near term.

Tobacco is only one essential component to the manufacture of cigarettes. Non-tobacco manufacturing materials are just as important, and in some ways more easily regulated. By licensing non-tobacco cigarette manufacturing materials, the government can make it more difficult to produce the volumes of illegal cigarettes that make their way into Canadian communities. Non-tobacco manufacturing materials are currently the only part of the cigarette making process that does not have significant government control or oversight.

Cigarette filters are the best place to start on this front. They are essential to the manufacturing process and not readily replaced. This would include ready-made filters, as well as acetate tow, the substance used in cigarette filters. Acetate tow is produced by only a handful of manufacturers globally. In contrast actual loose leaf tobacco is sourced from a variety of locations and smuggled into Canada.

There is broad support for increased licensing of acetate tow from virtually all stakeholders connected to tobacco. This includes health groups such as the Canadian Cancer Society, the Ontario Medical Association and the Heart and Stroke Foundation⁶. The province of Ontario has been investigating such regulations, but the international nature of its manufacturing makes this better addressed by the Federal Government. There would be negligible cost to government to implement such a system.

S-5 offers an opportunity introduce restriction on acetate tow. This can be done with a small amendment to the bill that would amend the excise act to regulate its importation and restrict it to licensed tobacco manufacturers.

Such a change is in keeping with the approach that S-5 takes towards tobacco control. S-5 adjusts Canada's regulatory framework to account for new products, like e-cigarettes, and to reflect different trends in tobacco control, like plain packaging. The goal of both of these changes is to ensure that Canada has the tools needed to reduce tobacco use.

The NCACT believes that, without other action, the introduction of plain packaging for tobacco products will increase the prevalence of contraband tobacco. Adding measures to restrict acetate tow will help reduce this, but such measures are a good idea regardless of what you think the impact of plain packaging on contraband tobacco products will be.

Reducing contraband tobacco increases the effectiveness of all tobacco control regulations, including those already in place. Addressing illegal cigarettes will have a more direct impact on increasing tobacco control in Canada than plain packaging regulations are likely to have. The Government of Canada should enforce existing regulations before moving forward with new ones. There is little point introducing additional regulations if the existing tobacco control regime is not being enforced.

Conclusion

The National Coalition Against Contraband Tobacco (NCACT) supports government efforts to curtail tobacco use.

⁶ Comments by Michael Perley, Ontario Campaign for Action on Tobacco, Ontario Standing Committee On Finance And Economic Affairs; 29 January 2015

Canada's tobacco market is already one of the most tightly regulated markets in the world. With restrictions on advertising, display, packaging, and strict requirements for identification, there are already numerous barriers between the general public and seeing and/or purchasing tobacco. Even the proposed expansion to plain packaging focuses only on the small portion of a package that is not currently regulated by government.

Unfortunately, Canada's illegal market undermines all of these measures. The illicit tobacco problem in Canada is relatively unique in the developed world, with an extremely high incidence - 1/3 of all cigarettes purchased in Ontario alone – and consisting of much higher mix of illegal local production than in other jurisdictions. The illegal market operates outside of Canada's strict tobacco control regime, giving Canadian smokers, and especially young people starting to smoke, ready access to cigarettes that are inexpensive and not behind the barriers listed above.

Adding additional tobacco control measures will not change this. Moreover, there is a very real risk that illicit production will take advantage of proposed regulatory changes to further mimic legal product and undermine regulations. Before new tobacco control measures are introduced, it is important to introduce additional, effective means of reducing contraband tobacco.